

**AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE
PROVINCIAL LEGISLATURE AND THE COUNCIL ON MHLONTLO MUNICIPALITY
REPORT ON THE FINANCIAL STATEMENTS**

Introduction

1. I was engaged to audit the accompanying financial statements of the Mhlontlo Municipality which comprise the statement of financial position as at 30 June 2010, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages xx to xx.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (GRAP) reporting framework and in the manner required by the Municipal Finance Management Act of South Africa, Act No. 56 of 2003 (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, Act No. 108 of 1996, section 4 of the Public Audit Act of South Africa, Act No. 25 of 2004 (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and General Notice 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

VAT Receivable

4. The VAT (Value Added Tax) receivable of R10.8 million as disclosed in note 10 to the financial statements does not agree to the balance of R11.8 million per the suspense account in the underlying accounting records. The municipality could not provide an explanation or other sufficient appropriate audit evidence for this reconciling difference between the financial records and the actual amount that could be substantiated by supporting documentation. Consequently the VAT receivable as disclosed in the financial statements is understated by R1 million. I could not determine the effect on the other account balances or classes of transactions contained in the financial statements.

Debtors

5. Included in consumer debtors net balances of R1.75 million as disclosed in note 8 to the financial statements, are unsubstantiated credit balances totalling R0.95 million for which no supporting documentation was available. There were no satisfactory alternative audit procedures that I could perform to determine the appropriate accounting treatment for these balances. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of consumer debtors.
6. Included in consumer debtor's gross balances of R17.52 million as disclosed in note 8 to the financial statements are receivables in the name of the municipality to the amount of R0.52 million. The municipality is currently unable to determine whether or not these are "own" debtors or whether they relate to legitimate consumers and has fully impaired, as opposed to reversing the transactions. Due to the lack of records there were no alternative procedures I could perform, and as a result sufficient appropriate audit evidence to verify the classification of these amounts could not be obtained.
7. The municipality could not provide sufficient appropriate audit evidence for other debtors of R0.55 million as disclosed in note 9 to the financial statements. There were no satisfactory alternative audit procedures that I could perform and consequently I could not confirm the existence, valuation or completeness of this amount.

Creditors

8. The municipality does not deduct or contribute unemployment insurance fund (UIF) contributions for its elected councillors as required by the Unemployment Insurance Contributions Act of South Africa, Act No. 4 of 2002. The full liability for outstanding contributions dating back to 2002/03 has not been accrued for by the municipality and consequently creditors as disclosed in note 3 to the financial statements is understated, and accumulated surplus is overstated by R0.8 million.

Financial instruments

9. The municipality did not charge interest on overdue debtors accounts and as a result does not reflect interest revenue in the statement of financial performance, and did not initially recognise receivables at their fair values as required by IAS 39 (International Accounting Standard 39: Financial Instruments: Recognition and Measurement.) Consequently interest earned – outstanding debtors as shown on the statement of financial performance is understated by R0.9 million, and it could not be determined what the subsequent accounting for any receivable recognised would have been. Consequently sufficient appropriate evidence relating to the classification of this amount as either an impairment or a debtor could not be obtained.
10. The municipality has not disclosed the nature and extent of risks arising from financial instruments as required by IFRS 7 (International Financial Reporting Standard 7 Financial Instruments: Disclosures.)

Capital Commitments outstanding

11. The municipality has not disclosed capital commitments outstanding at year end as required by GRAP 17: Property, Plant and Equipment (PPE.) There was no contract management system in place for the identification and recognition of these commitment disclosures and there were no satisfactory alternative audit procedures that I could perform to quantify the full extent of the understatement.

Property, Plant and Equipment

12. GRAP 17: PPE, read with Directive 4: Transitional Provisions for Medium and Low Capacity Municipalities require the municipality to have recognised all PPE assets. Even though the opening balance of PPE as disclosed in note 5 to the financial statements is reflected at zero (provisional values), the municipality is still required to maintain a complete listing of all PPE assets. The process to compile such a listing has not taken place and consequently the municipality has not recognised all PPE assets in the financial records.

Expenditure

13. Included in general expenses of R70.1 million as disclosed in note 30 to the financial statements, are goods and services received in the prior period to the value of R2 million that were not accrued for as at 30 June 2009. In addition prior period payroll liabilities also not accrued for at 30 June 2009 of R1.2 million are included in employee related costs of R24.5 million as disclosed in note 16 to the financial statements.
14. As a result of the above, general expenses and employee related costs for the current period are overstated by R2 million and R1.2 million respectively, while the corresponding figures for these expenditures are understated by the same amounts. Both the corresponding figures for creditors of R3.6 million, as disclosed in note 3 to the financial statements, and the accumulated deficit of R5.1 million are furthermore understated by R3.2 million in respect of the above items.
15. During the audit of the previous period, sufficient appropriate supporting documentation could not be obtained for payment vouchers as well as journal transactions now included in the corresponding figure for general expenses of R37.1 million as disclosed in note 30 to the financial statements. The entity's records did not permit the application of alternative audit procedures, and consequently I could not confirm the completeness, accuracy or occurrence of this amount included in the corresponding figures.

Other corresponding figures

16. The audit report for the year ended 30 June 2009 contained a disclaimer of opinion as a result of a limitation on the scope of the audit. No adjustments have been effected to the corresponding figures to correct the matters raised previously.
17. The municipality could not provide sufficient appropriate audit evidence to support journal entries debited and credited, reconciling items outstanding and for other balances now included in the corresponding figures for:
 - consumer debtors of R1.9 million disclosed in note 8 to the financial statements;
 - bank balances and cash of R2.3 million disclosed in note 12 to the financial statements;
 - call accounts of R0.6 million disclosed in note 11 to the financial statements;
 - and current provisions of R5 million disclosed in note 28 to the financial statements.

18. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance in the above circumstances, and consequently I could not confirm the existence, valuation, completeness or rights and obligations of the abovementioned amounts included in the corresponding figures.
19. The valuation roll used to support the corresponding figure for property rates revenue, of R1.9 million billed in the previous period and disclosed in note 13 to the financial statements, did not include all ratable properties within the municipality's boundary. In addition unexplained reconciling items for the corresponding figures of government grants and subsidies revenue of R60.8 million, and amounts included in other income of R2.9 million, as disclosed in notes 15 and 29 to the financial statements respectively, had no sufficient appropriate supporting documentation. No alternative audit procedures could be performed in these circumstances and as a result I could not confirm the completeness, accuracy and occurrence of the abovementioned amounts included in the corresponding figures.

Disclaimer of opinion

20. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

21. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Unauthorised, Fruitless and wasteful and Irregular expenditure

22. As disclosed in note 24.1 to the financial statements unauthorised expenditure of R7.2 million was incurred primarily as a result of overspending the budget per vote for two votes.
23. As disclosed in note 24.2 to the financial statements fruitless and wasteful expenditure of R34 538 was incurred as a result of interest charges on late payment of creditors by the municipality.
24. As disclosed in disclosure note 24.3 to the financial statements, irregular expenditure amounting to R0.8 million was incurred as a result of overspending of approved contract amounts.

Additional matter

25. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

26. The supplementary appendices A - D do not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REPORTING REQUIREMENTS

27. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA, Municipal Systems Act of South Africa, Act No. 32 of 2000 (MSA), Division of Revenue Act of South Africa, Act No 12 of 2009 (DoRA) the Municipal Supply Chain Management Regulations of South Africa (GNR 868 of 30 May 2005) (SCM regulations), and financial management (internal control).

Predetermined objectives

28. Material findings on the report on predetermined objectives are reported below:

Non-compliance with regulatory and reporting requirements

No reporting against predetermined objectives, indicators and targets

29. We could not conduct the audit of performance against pre-determined objectives as the Mhlontlo Municipality did not prepare the annual performance report as required in terms of section 46 of the MSA.

Lack of adoption or implementation of a performance management system

30. The municipality did not establish and implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the relevant roles as required in terms of sections 38 and 41(2) of the MSA.

No mid-year budget and performance assessments

31. The accounting officer did not assess mid-year performance of the municipality as required by section 72 of the MFMA.

Inadequate content of integrated development plan

32. The integrated development plan of the municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA, and also omitted the financial plan required in terms of section 26(h).

Submission of integrated development plan

33. The municipality did not submit the integrated development plan to the MEC for Local government within 10 days after adoption of the plan as required by section 32(1)(a) of the MSA.

Compliance with laws and regulations

Expenditure was not paid within the parameters set by the applicable legislation

34. The municipality did not pay its creditors within 30 days after receiving invoices as required by section 65(2)(e) of the MFMA.

Expenditure was incurred otherwise than in accordance with section 15 of the MFMA resulting in unauthorised expenditure

35. Contrary to section 15 of the MFMA the municipality incurred unauthorised expenditure due to overspending the budget for two votes.

Expenditure incurred was made in vain or could have been avoided resulting in fruitless and wasteful expenditure

36. Contrary to section 78(c) of the MFMA the municipality paid interest in vain due to not paying its supplier within 30 days after the receipt of invoice.

Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure

37. Contrary to section 78(c) of the MFMA the municipality incurred irregular expenditure due to overspending of approved contracts awarded.

The accounting officer did not adhere to his statutory responsibilities

38. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal control as required by section 62(1) of the MFMA.
39. The accounting officer did not submit monthly reports to provincial treasury as required by section 71 of the MFMA.
40. The accounting officer did not place on the website the documents referred to in section 21A of the MSA as required by section 75 of the MFMA.
41. The accounting officer did not implement a credit control and debt collection policy as required by section 100(a) of the MSA.
42. Performance contracts were not signed by the municipal manager and those managers directly reporting to the municipal manager as required by section 57 of the MSA.

Supply Chain Management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

43. The accounting officer did not establish capacity in the administration of the municipality to ensure that contracts are properly enforced and in monitoring the performance of contractors as required by section 116(2)(b) of the MFMA.
44. Contrary to regulation 18(a) of the SCM regulations, invitations to submit formal written quotations for procurement in excess of R30 000 were not advertised for seven days on the website and official notice board of the municipality.
45. The municipality did not establish a bid specification committee as required by regulation 26(a)(i) of the SCM regulations.

The financial statements were not prepared in accordance with applicable legislation

46. The financial statements submitted for audit did not comply with section 122(1) of the MFMA. Material misstatements were identified during the audit, certain of these were corrected by management and those that were not are included in the basis for disclaimer of opinion paragraphs.

Financial interests were not disclosed in accordance with the legislation

47. The councillors did not declare their interest as required by schedule 1 paragraph 7(1) of the MSA.
48. The staff members did not declare their interest as required by schedule 2 paragraph 5A(1) of the MSA.

INTERNAL CONTROL

49. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the acts as indicated above, but not for the purpose of expressing an opinion on the effectiveness of internal control.
50. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Achievement of internal control objectives

Leadership

51. Management only partially implemented appropriate corrective actions for control deficiencies and findings identified in the prior year, and did not develop and implement policies and procedures for key financial components at the municipality. In addition the municipality did not have sufficient monitoring controls to ensure adherence to those internal policies and procedures that were implemented, as well as for the purposes of taking corrective action where required.

Financial and performance management

52. General information technology controls are not designed to maintain the integrity of the information systems for financial reporting. Management did not implement appropriate control measures to ensure that all revenue due to the municipality is collected, and long-outstanding receivables were not handed over to attorneys for follow up. Significant documentation and other information could not be obtained for audit purposes, and there were material misstatements identified in the financial statements for which no appropriate controls exist to confirm the reported amounts. Prior year opening balances were not corrected before the current financial statements were prepared.

Auditor General

East London

30 November 2010



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence